

## Internal Revenue Service

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### Legend

Taxpayer =  
State 1 =  
State 2 =  
Organizations A =  
Energy =  
Utility =  
Municipally-Owned  
Utilit(y)(ies) =

Members =

Dear :

This letter responds to a ruling letter request from your authorized representatives dated October 2, 2019 and subsequent correspondence requesting a ruling that Taxpayer's income is excluded from gross income under section 115(1) of the Internal Revenue Code (Code).<sup>1</sup> The Taxpayer represents the facts as follows.

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<sup>1</sup> The Internal Revenue Code of 1986, as amended, to which all subsequent "section" references are made unless otherwise indicated.

### Facts and Representations

Taxpayer is a nonprofit corporation organized under the laws of State 1. Taxpayer's articles of incorporation provide that Taxpayer shall only serve such purposes and functions and shall engage in such activities as are consistent with the requirements for an organization, the income of which is excluded from gross income under section 115 of the Code. Taxpayer was created for the purposes of maximizing the efficient provision and use of Energy resources, reducing operating costs, and increasing the operating revenues of the Members without affecting the safety and reliability of the Energy system of each Member.

Taxpayer currently has six members: Members. Taxpayer represents that each Member of Taxpayer is a public utility entity and either a political subdivision within the meaning of the Code or an entity whose income is excluded from gross income under section 115 of the Code. Taxpayer's mission is to assist Municipally-Owned Utilities in furtherance of their governmental function of providing utility service to the residents of their jurisdictions. The Municipally Owned Utilities served by Taxpayer are political subdivisions within the meaning of the Code and entities whose income is excluded from gross income under section 115 of the Code. Any future member of Taxpayer must be a public Utility and either a political subdivision within the meaning of the Code or an entity whose income is excluded from gross income under section 115 of the Code.

Taxpayer is governed by a board of directors. The board of directors shall consist of a total number equal to the number of Taxpayer's members, in addition, Organization A<sup>2</sup> (a not-for-profit corporation described in section 501(c)(6) of the Code organized under the laws of State 2, created to promote public utilities and help community-owned utilities deliver superior services through joint advocacy, education and collaboration) shall have the right to appoint one director.<sup>3</sup> Taxpayer's bylaws also provide that the president/CEO and the General Counsel of Taxpayer will serve as ex-officio non-voting directors of Taxpayer.

The Municipally-Owned Utilities served by Taxpayer vary in size and scope of their enterprise, e.g., some of these Municipally-Owned Utilities may own and operate a complete system that generates, transmits and distributes Energy to their service areas and some may only own and operate distribution systems and purchase the Energy that they need to provide power to their service areas. Regardless of their size and scope, each Municipally-Owned Utility is engaged in a complicated and multifaceted operation in managing their energy supply, providing energy to their customers in a reliable fashion, managing the budget for such operations, and protecting their facilities and

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<sup>2</sup> Organization A is a national trade organization representing public utilities advocating on behalf of municipally-owned utilities throughout the United States. Under a service agreement, Taxpayer receives enhanced membership benefits from Organization A.

<sup>3</sup> If Taxpayer has more than thirteen directors, then the Taxpayer's board of directors may grant Organization A an additional director.

operations from threats, physical, cyber, or otherwise. Taxpayer's primary purpose is to help Municipally-Owned Utilities obtain the information, products and services they need to accomplish their function of providing Energy service to the public efficiently, economically, and reliably.

Taxpayer's current business plan consists of three general business lines. Taxpayer's business lines focus on pooling the purchasing power of government entities, reducing costs by performing joint analysis, consolidating bidding and contracting, and serving as a products and resource guide. The services provided by Taxpayer (which are services that each Member could perform on their own behalf) allow Members and Municipally-Owned Utilities to take advantage of economies of scale, promote efficient operation, and ultimately reduce costs.

Taxpayer represents that it receives income from fees for: (1) providing subject matter experts to Members and Municipally-Owned Utilities and their governing officials. Taxpayer provides onsite facilitation, workshops, and follow-up consultations for Members and Municipally-Owned Utilities. Taxpayer staff works in-depth with the utility board and staff to develop a realistic, step-by-step blueprint for adapting to specific market conditions, regulatory changes, and the complex expectations of customers. Taxpayer staff briefs governing officials on industry conditions and offers training on how to work with, and guide, the utility staff. Taxpayer also provides experts in human resources, financial analysis, transitions to renewable energy and cybersecurity. Many Municipally-Owned Utilities may lack the resources to have an expert in every area on staff, or simply do not need a full-time equivalent employee in a certain area or areas; (2) providing a group purchasing program in which Taxpayer negotiates to obtain volume discounts and also to provide access to purchase products and services that are not otherwise available to the Members and Municipally-Owned Utilities with smaller customer bases; and (3) providing a metering program, in which Taxpayer provides infrastructure (meters, wireless network communications, applications, and systems integration) at a reduced cost through wholesale pricing on meters, network equipment and applications. By aggregating Members and Municipally-Owned Utilities in a single large-scale program, Taxpayer is able to attract high quality vendors with competitive pricing that individual Members and Municipally-Owned Utilities would not attract. Taxpayer's program also provides back office applications, IT infrastructure and supporting staff as a shared service.

Taxpayer's bylaws provide that a separate capital account is to be maintained for each Member of Taxpayer. The initial capital account of each such Member shall be equal to the dollar amount of the initial capital contribution of such Member and (1) shall be increased for any additional capital contributions and for such Member's periodic share of net income, and (2) shall be decreased for such Member's periodic share of losses and any distributions or for failure to meet capital calls. Upon dissolution of Taxpayer, after making payment for all liabilities, the Taxpayer's board of directors is to dispose of all assets by distributing the net assets (assets less liabilities) to the Taxpayer's Members in proportion to their respective capital account balances. Since Organization

A is not a Member<sup>4</sup>, no capital account will be established for Organization A and Organization A does not and will not share in any of the net income, or receive any net assets upon dissolution, of Taxpayer.

### Law and Analysis

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income generated by an investment fund that is established by a state to hold revenues in excess of the amounts needed to meet current expenses is excludable from gross income under section 115(1) of the Code, because such investment constitutes an essential governmental function. The ruling explains that the statutory exclusion is intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of an entity engaged in the operation of a public utility or the performance of some governmental function that accrues to either a state or political subdivision of a State. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a State government and that are within the ambit of a sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (e.g., casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under section 115(1) of the Code because the organization is performing an essential governmental function. The revenue ruling states that the income of such an organization is excludable from gross income so long as private interests do not participate in the organization or benefit more than incidentally from the organization. The benefits to the employees of the insurance coverage obtained by the member political subdivisions are deemed incidental to the public benefit.

Taxpayer's provision of the services as described above constitutes performance of an essential governmental function within the meaning of section 115 of the Code. See Rev. Rul. 90-74 and Rev. Rul. 77-261.

In no event, including dissolution, will the Taxpayer's assets be distributed or revert to any entity that is not a state, a political subdivision of a state, or another entity the income of which is excludable from its gross income by application of section 115 of the Code. No private interests will participate in, or benefit from, the operation of the Taxpayer other than as providers of goods or services. See Rev. Rul. 90-74.

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<sup>4</sup> No capital account will be established for any Municipally-Owned Utility unless that entity is also a Member of Taxpayer.

Ruling

Based solely on the facts and representations submitted by Taxpayer, we conclude that the income of Taxpayer is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof, or to an entity the income of which is excluded under section 115(1) of the Code. Consequently, we rule that Taxpayer's income as described above is excluded from gross income under section 115(1) of the Code.

The ruling contained in this letter is based upon information and representations submitted by or on behalf of Taxpayer and accompanied by a penalty of perjury statement executed by an individual with authority to bind Taxpayer and upon the understanding that there will be no material changes in the facts. While this office has not verified any of the material submitted in support of the request for this ruling, it is subject to verification on examination. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2020-1, section 11.05.

This letter does not address the applicability of any section of the Code or Regulations to the facts submitted, other than those sections specifically described. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed as to whether any Member of Taxpayer or Municipally-Owned Utility is a political subdivision within the meaning of the Code or an entity whose income is excluded from gross income under section 115 of the Code. Additionally, no opinion is expressed as to whether Organization A is an entity described in section 501(c)(6) of the Code. Further, no opinion is expressed as to whether income from services from any of Taxpayer's future lines of business that are not expressly described above are excluded from gross income under section 115 of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

James Zelasko  
Chief, Branch 2  
(CC:EEE:EOET:EO2)  
Office of Associate Chief Counsel (Employee  
Benefits, Exempt Organizations, and Employment  
Taxes)

cc: